Putting the Horse before the Cart: The First Rule of Granting Fed Accounts is Clarifying Who is Legally Eligible to Apply

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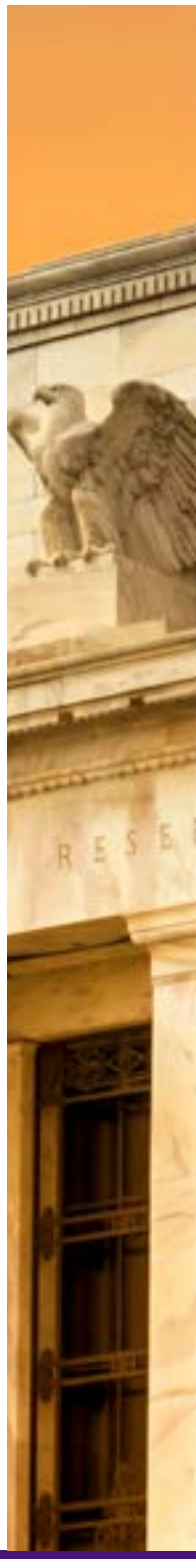
The Federal Reserve has issued for comment a set of proposed guidelines on access to Federal Reserve master accounts and Reserve Bank financial services by companies with novel charters.[1] A key threshold question is which entities are legally eligible to apply for a Federal Reserve account. In its proposed guidelines, the Federal Reserve acknowledged that this question requires an answer but decided that now was not the time.[2] This note attempts to identify the relevant law on legal eligibility and identify areas of possible ambiguity requiring clarification.



CURRENT ELIGIBILITY

The Federal Reserve's Operating Circular 1 identifies the institutions that are currently eligible for a master account and services:[3] member banks, commercial banks, mutual savings banks, federal savings banks, savings and loan associations, credit unions, a U.S. branch or agency of a foreign bank and an Edge or agreement corporation. The Operating Circular also includes "other entities authorized to have a Master Account at a Reserve Bank," such as U.S. government agencies and government-sponsored enterprises.

The Federal Reserve's authority to provide an account and services derives from the Federal Reserve Act. Section 13 of the Act authorizes each of the 12 Federal Reserve Banks to accept deposits from "member banks, or other depository institutions" and to accept deposits from "any nonmember bank or trust company or other depository institution" "solely for the purposes of exchange or of collection."[4] At the time section 13 was enacted, only member banks were eligible to obtain an account and services.[5] Over time, the Act has been amended to include nonmember banks and trust companies, and also "other depository institutions." The addition of "other depository institution" was made in 1980 in order to expand the universe of institutions to which the Federal Reserve Act's reserve requirements apply to include not only Federal Reserve member banks, but also any other bank that accepted deposits.[6]

ELIGIBILITY OF NOVEL CHARTERS THAT TAKE DEPOSITS

If an entity with a novel charter accepts deposits, is it legally eligible? It depends on this question: what is a "depository institution"?

Section 19 of the FRA defines "depository institution" for this purpose as including various banking entities that are insured either by the FDIC, but also any of these entities that is "eligible to make an application to become" insured under section 5 of the Federal Deposit Insurance Act (FDI Act).[7] The FDI Act provides that an institution

must be "engaged in the business of receiving deposits other than trust funds" in order to make an application to become insured.[8] Through its regulations, the FDIC has further interpreted this phrase by stating that "a depository institution shall be 'engaged in the business of receiving deposits other than trust funds' only if it maintains one or more non-trust deposit accounts in the minimum aggregate amount of $500,000."[9] It therefore appears that the definition of "depository institution" in the Federal Reserve Act applies to institutions that accept a minimal amount of deposits, even if they are not insured by the FDIC.

Several novel institutions and charter types have been designed to accept uninsured deposits and therefore would appear to be a "depository institution" under the FRA and legally eligible to apply for a master account and services.

ELIGIBILITY OF NOVEL CHARTERS THAT DON'T TAKE DEPOSITS

So what about entities with novel charters that do not accept deposits; are they eligible? It is much less clear.

The OCC has announced plans for two such novel charters; each would permit some variation of payments or lending, but both would prohibit deposit-taking.[10] The OCC has not approved any of these charters yet; in fact, no applications have even been filed. However, any eventual applicant likely would seek a Fed account in connection with the novel charter. Because institutions that do not take deposits would not qualify as "depository institutions" or "other depository institutions," they would need to qualify for eligibility in another way.[11]

It is possible that such institutions could claim that they are "national banks" under the Federal Reserve Act, which are by definition also Fed "member banks."[12] Member banks are legally eligible for Fed accounts under section 13 of the Act.

So, are these institutions "national banks" under the Federal Reserve Act? The Act does not define "national bank" except to say that it is "synonymous with national banking association."[13] The Act does not define "national banking association" or even "banking association." The Act defines a "bank" in relevant part as "a State bank, banking association, and trust company, except where national banks are specifically referred to."[14]

Thus, the statute is not a model of clarity on this point, and so it is likely to be a matter of first impression for the Fed to decide. Certainly, the OCC labels these entities as "national banks" under the National Bank Act, but that is not determinative here. The relevant federal law (the one that requires national banks to be member banks) is the Federal Reserve Act, which means the Federal Reserve and not the OCC is responsible for interpreting and resolving any unclear or ambiguous terms.

Stepping back, we would posit that these kinds of OCC entities are better thought of as

"national payments companies" or "national lending companies," or both, but not "national banks." And the Federal Reserve Act does not contemplate allowing national payments or lending companies to have Fed accounts. Here, it is worth noting that if one these OCC entities had a state license, it would not be a "bank" license but rather would be a money transmitter license or a lending license. Thus, just because these entities would have a federal charter from the OCC does not mean they should presumptively be deemed "national banks" under the Federal Reserve Act and entitled to Fed accounts.

FEDERAL RESERVE AUTHORITY TO PROVIDE MASTER ACCOUNTS AND SERVICES

The FRA does not explicitly authorize a Federal Reserve Bank to provide services, but rather implies that authority in section 11A. That section requires the Federal Reserve to establish pricing principles and a schedule of fees for the services offered by the Reserve Banks. It also provides that "Federal Reserve bank services covered by the fee schedule shall be available to nonmember depository institutions…" -- thus implying that services are available to both member banks and nonmember banks.

In addition to the lack of explicit authorization to provide services, the Federal Reserve Act does not require a Federal Reserve Bank to provide an account to an applicant. The statute states that a Reserve Bank "may receive from any of its member banks, or other depository institutions,…deposits of current funds…" The use of the word "may" indicates that each Reserve Bank retains discretion as to whether to accept deposits from an institution, which means it also has discretion as to whether to provide an account. The Federal Reserve has also come to this conclusion. In recent litigation with an applicant for a Master Account, the Federal Reserve Bank of New York said that section 13 of the FRA "permits Federal Reserve Banks to reject deposits – and thus deposit account requests – from depository institutions."[15] The Federal Reserve has reiterated this view in its proposed guidelines, stating that it "believes it is important to make clear that legal eligibility does not bestow a right to obtain an account and services."[16]

CONCLUSION

Whether or not the Federal Reserve determines that novel charter types and novel institutions are technically "eligible" to apply for a Federal Reserve master account or for access to Reserve Bank services, none of the 12 Reserve Banks is required to provide such accounts and services. There are strong considerations both with respect to risk to the system and policy concerns that must be considered before the Federal Reserve permits these institutions to access the system. The Federal Reserve has taken an important first step in proposing a set of the standards that must be met before an institution is permitted to open a master account or access Reserve Bank services. The continued safety and integrity of the payment and financial system depends on careful examination of these institutions to ensure they meet those standards, and the Reserve Banks should not compromise on those standards.

[1] 86 Fed. Reg. 25865 (May 11, 2021).
[2] "[The] Board is considering whether it may in the future be useful to clarify the interpretation of legal eligibility under the Federal Reserve Act for a Federal Reserve account and services." 86 Fed. Reg. at 25866.
[3] Federal Reserve Banks Operating Circular 1, Effective February 1, 2013, available at https://www.frbservices.org/assets/resources/rules-regulations/020113-operating-circular-1.pdf
[4] 12 U.S.C. § 342.
[5] "Member banks" are those that are members of the Federal Reserve System and includes both state-chartered institutions that elect to become members and national banks.
[6] Depository Institution Deregulation and Monetary Control Act, section 105(a), PL 96-221, 94 Stat. 132, 139-140.
[7] 12 U.S.C. § 461(b)(1)(A).
[8] 12 U.S.C. § 1815(a).
[9] 12 CFR 303.14(a).
[10] The first novel charter is the Special Purpose National Bank charter for FinTech companies, which would permit these companies to engage in lending and payments, but not accept deposits. The OCC has not chartered any companies under the special purpose national bank charter, largely because the OCC's authority to issue the SPNB charter has been tied up in litigation in federal court for the past five years. Recently the U.S. Court of Appeals for the Second Circuit ruled that any legal challenges to the SPNB charter aren't ripe because the OCC hasn't approved any such charters. The Second Circuit dismissed the claims on procedural grounds without prejudice to the underlying merits of the challenge. See Lacewell v Office of the Comptroller of the Currency, No. 19-4271 (2d Cir. Jun. 3, 2021). The second novel charter is a national payments bank charter, which would permit companies to engage in payments, but not deposit-taking or lending. For a description of this charter, see https://bankingjournal.aba.com/2020/06/podcast-occs-brooks-plans-to-unveil-payments-charter-1-0-this-fall/
[11] The Federal Reserve Act does not directly contemplate eligibility for any kind of non-depository institutions, as these OCC institutions would be. Moreover, they wouldn't appear to qualify as commercial banks, mutual savings banks, federal savings banks, savings and loan associations, credit unions, a U.S. branch or agency of a foreign bank or an Edge or agreement corporation.
[12] The Federal Reserve Act requires that national banks be members of the Federal Reserve System. See 12 U.S.C. § 222.
[13] 12 U.S.C. § 221.
[14] 12 U.S.C. § 221.
[15] TNB USA Inc. v Federal Reserve Bank of New York, Memorandum of Law in Support of Defendant Federal Reserve Bank of New York's Motion to Dismiss, U.S. District Court, Southern District of New York, Civ. No. 18 Civ. 7978, Mar 8, 2019.
[16] 86 Fed. Reg. 25865, 25867 (May 11, 2021).